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USING STATE-LEVEL EVIDENCE TO INFORM NATIONAL POLICY: RESEARCH FROM THE STATE HEALTH ACCESS REFORM EVALUATION (SHARE) PROGRAM

Using Payroll Deduction to Shelter Individual Health Insurance from Income Tax

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Objective. To assess the impact of state laws requiring or encouraging employers to establish "section 125" cafeteria plans that shelter employees' premium contributions from tax.
Data Sources. Available descriptive statistics, 65 key-informant interviews, and relevant documents in study states and nationally, 2008–2009.
Study Design. Case studies were conducted in Indiana, Massachusetts, and Missouri—three states adopting laws in 2007. Descriptive quantitative information came from insurers, regulators, and surveys of employers. In each state, 15–17 semistructured but open-ended interviews were conducted with insurance agents, insurers, government officials, and third-party administration firms, and 29 informed sources were interviewed from a national perspective or other states. Key informants were selected based on their known or reported experience, in a "snowball" fashion until saturation was reached. Interview notes were coded for systematic analysis. Finally, relevant rulings, brochures, instructions, marketing materials, and other documents were collected and analyzed.
Findings. Despite the potential for substantial cost savings, use of section 125 plans to purchase individual insurance remained low in these states after 1 or 2 years. Absent a mandate, few employers were strongly motivated to offer these plans in order to retain an adequate workforce, and uncertainty about federal legality deterred doing so. For smaller employers, benefits to owners did not outweigh administrative complexities. Nevertheless, few downsides were found to states mandating or encouraging these plans. In particular, there is little evidence that many employers dropped group coverage as a result.
Conclusions. Section 125 plans remain a limited tool for states to reduce the inequitable tax treatment of individually purchased insurance, but a complete remedy requires reform of federal tax law.

Key Words. Health insurance, law, taxation, cafeteria plans, crowd-out, list-billing

BACKGROUND

The Patient Protection and Accountable Care Act of 2010 (PPACA) fundamentally changed much about the way health insurance is bought and paid

for, but one thing it left unchanged is how individual (nongroup) insurance is taxed. Widespread opinion (among health economists and others) holds that it is inefficient and inequitable to exclude from taxable income employer-sponsored premiums but not individually paid premiums. As PPACA does not change this key feature of tax law, it remains a potential concern for states in the implementation of reforms.

Before PPACA, some states and employee benefits experts found a creative way to exploit existing tax laws to eliminate this disparity between individual and group insurance. This work-around uses "section 125 plans" (also known as "cafeteria plans") to shelter from tax the portion of insurance premiums paid by employees. Section 125 of the Internal Revenue Code is the provision that allows employers to set up flexible spending accounts (FSAs), through which workers can reduce their taxable, take-home wages in order to pay for optional expenses such as childcare and health care. In addition to standard FSAs, the Internal Revenue Service also allows a simple form of a section 125 plan known as a "premium-only plan," which employees use only to pay for health insurance premiums.

Larger employers (or their benefits and payroll administrators) commonly establish premium-only cafeteria plans to shelter the portion of the group insurance premium that is paid by employees. What is much less common, and more innovative, is to use section 125 plans to pay for individual insurance, pretax and through payroll deduction, when the employer contributes nothing toward the premium. Employers who do not offer health insurance are not strongly motivated to offer this optional employee benefit, and so seldom do. Yet doing so could potentially save a substantial percentage of the premium cost for workers who buy their own insurance—typically 30–40 percent, but sometimes more—by excluding the premium from the base of income on which they otherwise would be taxed.

Using section 125 plans for individual insurance is legally controversial, however, under both federal and state law (Hall and Monahan 2010). Federal legal issues are discussed below. Under state law, insurance regulators often prohibit or frown on the practice known as "list-billing," in which insurers sell

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individual coverage through payroll deduction, by sending employers a bill listing the specific premiums for employees who have enrolled (Goodman 2006; Wieske 2006). Regulators view list-billing for individual insurance as a way to circumvent the small group reform laws that require employers to cover all eligible workers on equal terms. List-billing can be done without using a section 125 plan, but adding this tax advantage makes list-billing more attractive. Therefore, some state insurance regulators prohibit using section 125 plans for individual insurance, or they discourage this in various ways that convince insurers and agents that it is not legally or politically safe to promote or facilitate this arrangement (Hall and Monahan 2010).

To overcome these barriers, several states in the past few years enacted laws that either require or assist employers to establish section 125 plans covering employees' health insurance premiums (Cauchi 2008; Robert Wood Johnson Foundation 2009). Some are freestanding measures, but others were part of more comprehensive reforms. Most prominently, Massachusetts required employers with 11 or more full-time workers to establish a premium-only section 125 plan, effective July 2007. Missouri adopted a provision effective January 2008 that allows small employers to both set up and to contribute to section 125 plans for employees who purchase individual coverage.[1] Indiana since 2008 has offered a tax credit of U.S.$50 per employee, for up to 50 employees, to any uninsured employer that establishes a section 125 plan covering employees' insurance premiums.

These three first-adopting states are the main focus on this study, but several other states have enacted similar measures (SHARE 2009).[2] Also, even without legislation, some state insurance regulators have reinterpreted their small-group laws to allow tax-sheltered payroll deduction for nongroup coverage.

These low cost measures could accomplish a lot, either standing alone or in conjunction with other reforms. By reducing the effective price of insurance, section 125 plans might increase compliance with the new federal mandate to purchase coverage. Even if the impact is modest, proponents claim section 125 plans would do no harm. To find out more, this study evaluates three different efforts in Massachusetts, Missouri, and Indiana to shelter from tax the insurance premiums paid by employees.

Research Design, Methods, and Data

This is a mixed-methods comparative case study. Descriptive quantitative information came from insurers, regulators, and surveys of employers. Qualitative

information came from 65 semistructured interviews with key informants in mid 2008 to mid 2009, as follows: Interviewed in each state were five to eight agents or benefits advisors (including those with both small and large clients), two to four insurers (including the largest in each state), three government officials, two third-party employee benefits administrators, and one to two employer groups. Also interviewed were 23 informants in other statues or who had national perspectives and expertise (such as trade associations, national insurers, and major national benefits consultants and third-party administrators).

Interviews were in person or by phone, following a guide that covered each category of informant, but responses were open ended and lines of questioning flexible. Analysis used standard qualitative approaches (Shortell 1999), looking for consistency or variation across different perspectives, information sources, and case studies.

RESULTS

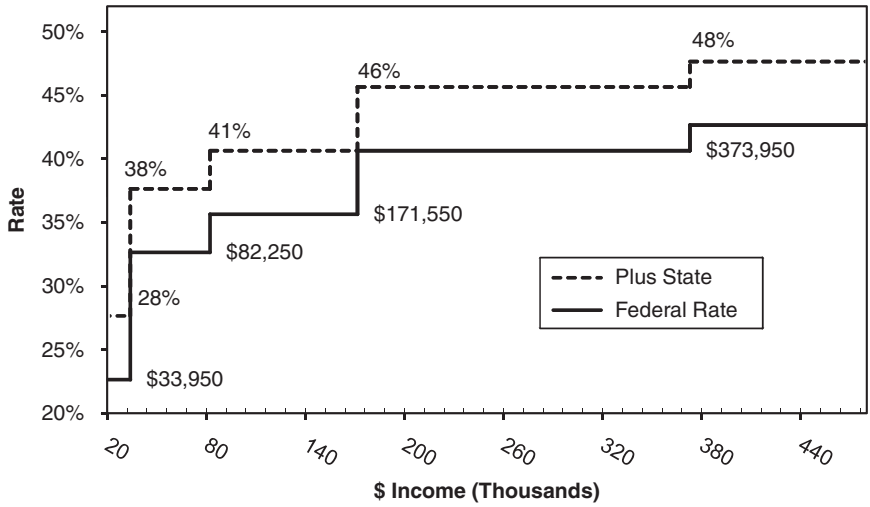
Cost-Reducing Effects

The cost-reducing benefits of the section 125 tax shelter depend on one's tax bracket (Figure 1). Federal income tax brackets range from 10 to 35 percent and lower-income people receive extra benefits under the earned income tax credit (Quincy 2008a, b).[3] Also saved are Social Security and Medicare "FICA" taxes of 7.65 percent, and any state and local taxes. In these case studies, state and local income taxes ranged from roughly 4–6 percent, but in some states they are 10 percent or more.[4] The cumulative tax savings can be quite impressive, even for some lower-income workers as illustrated in Figure 2.

Employers also benefit. Payroll taxes and assessments do not apply to wages in cafeteria plans. These taxes include the employer's matching 7.65 percent for FICA, and unemployment insurance in many states (typically, from 1 to 5 percent but sometimes higher for specific industries). An employer that had 10 workers opting for U.S.$5,000 coverage might save roughly U.S.$5,000 a year.

Reducing costs should increase coverage. A 2008 study by Mathematica estimated that, in Minnesota, requiring all employers to offer section 125 plans would increase the number of people with individual insurance by 6.3 percent, which would reduce average premiums by 5–6 percent, thus reducing the number of uninsured by 12.4 percent (Chollet et al. 2008). Nationally, in estimating the impact of President Bush's proposal to provide a more generous tax credit regardless of source of insurance, the Congressional Budget Office

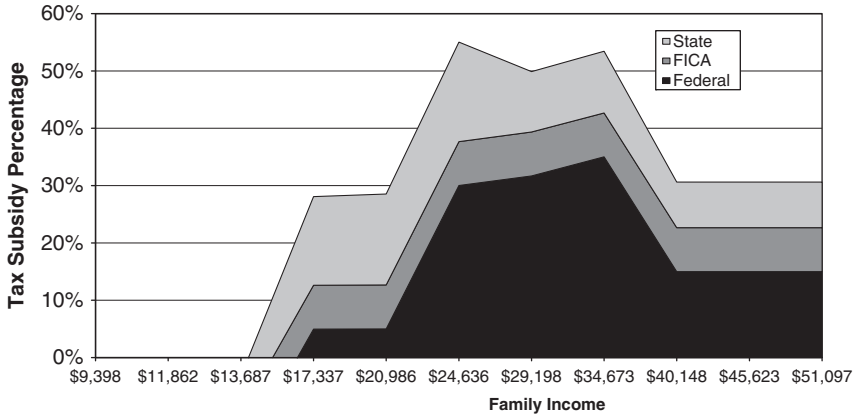
Figure 1: Tax Rates—Federal Plus State Single, 2009



Assumes state/local rate of 5 percent. Federal rate includes 7.65 percent FICA tax.

(CBO) (2007) concluded that equalizing the tax treatment of individual and employer insurance (as section 125 plans do) would increase newly insured individuals by about 7 million.

Figure 2: Potential Marginal Tax Rates Facing a Single Parent with Two Children (Negative Rates Not Displayed) (2008)*



*Assumes that the state levies an income tax and has a state EITC (most advantageous scenario). Adapted from Quincy (2008b)(reprinted with permission).

Insurance Expansion Effects

Despite this potential, the initial take-up of individual insurance under section 125 plans was very low to nonexistent after 1 or 2 years in each study state. Massachusetts had the most take-up. It coupled the section 125 employer mandate with an "individual mandate" unless available insurance costs exceed a state-defined affordability threshold. Despite this mandate, only a few thousand individuals in Massachusetts purchased their insurance through this tax shelter. Complete figures are not available statewide, but they are reported for insurance sold through the state's "Commonwealth Connector." As of July 2009, only 1,352 of the Connector's 15,385 nongroup subscribers purchased through a section 125 plan, from among at least 3,500 employers who had established their section 125 plans with the Connector. The two largest private insurers reported "similar" or "negligible" enrollment, suggesting that the statewide total was probably broadly around 5,000.

In the other two states, which allowed or incentivized section 125 plans but did not require them, few employers had adopted them, and so naturally few employees used them. In Missouri, a health policy expert said that provision has "not come up once" in his extensive conversations across the state.

Indiana's tax credit has been only modestly more successful. In 2008, 204 employers, uninsured previously, claimed the credit for establishing section 125 plans. They enrolled at least 2,900 employees, based on the total credit claimed of U.S.$145,000. That amount, however, is only about 10 percent of what legislative budget analysts predicted. Of the eight experienced insurance agents and benefits consultants interviewed in the state, half were completely unaware of the tax credit law. The others remarked on how little interest it has generated.

Employee Take-Up

Why do not more employees, when given the opportunity, choose to purchase their own insurance, or coverage for family members, with pretax payroll deduction? Massachusetts interviews supplied most (but not all) of the explanations we heard. One frequent observation was simply that insurance remains unaffordable, despite the substantial discounts. Related to this, several people noted that a tax shelter vehicle is not an especially good fit for the lower-wage workers who are more likely to lack group insurance.

Naturally, a lower tax bracket confers less of a discount, but also, the discount is only implicit and so does not decrease the visible premium cost. Experienced advisors noted that workers who "live paycheck to paycheck,"

"just trying to put food on the table," are "put off" by the requirement that money is first deducted from wages and then later used to pay next month's insurance bill. This reluctance is confirmed by studies showing low use of FSAs by lower-wage workers, even when they incur the dependent care and medical costs that FSAs cover (Feldman and Schultz 2001; Hamilton and Marton 2008).

Insurance agents said they are not highly motivated to encourage section 125 plans for individual insurance. They offer to set up section 125 plans for employers as another "arrow in their quiver" to "get in the door," but only as a way to sell group, not individual, insurance. As a Missouri agent said, "How hard do I want to work to get an appointment with an employer who doesn't want to provide health insurance?"

Many employers also lack motivation to promote understanding and use of section 125 plans. The lower-wage and part-time workers who most likely lack group insurance are also the part of the workforce that employers have the least investment in, and the least concern about losing. Also, part-time workers often do not consistently earn enough to pay an entire premium from their paychecks, and there is no ready way through section 125 plans to supplement premium payments from nonpayroll sources.

In sum, there was little confidence that section 125 plans had the potential to greatly increase coverage among those who otherwise would remain uninsured. Instead, several informed sources thought that their main benefit is to reduce the effective costs for those who otherwise already have individual insurance. That reality, however, did not undermine support for these laws, which was widespread across these states. Informants from multiple perspectives thought that it is manifestly unfair to deny a tax break only to those who lack employer-sponsored insurance, and they noted repeatedly that providing a tax break to both employees and employers is a "no brainer," "win/win" proposition, especially when most of the tax revenues are foregone by federal rather than state government. Also, several policy analysts noted that reducing individuals' effective costs can reduce the portion of premiums that government would have to subsidize in order to bring more people within a defined affordability range.[5] However, for these benefits to be realized, employers first must establish section 125 plans.

Employer Take-Up

These study states reflect three distinct methods to induce employer take-up: a mandate, a tax credit, and merely permitting the use of section 125 for "list-billed" individual insurance. The level of employer adoption observed in each

state tracks the stringency of these different measures. Missouri, which only permits this arrangement, experienced almost no detectable activity (but this was influenced considerably by the federal legal issues discussed below). Indiana, which provides a tax credit, saw adoption by 204 previously uninsured employers in 2008. Massachusetts reported widespread compliance with its mandate of employers with 11 or more full-time workers. Based on filings with the state in 2008, fewer than 10 percent of employers subject to the mandate had failed to comply, and fewer than 5 percent of employers with more than 50 employees. As a result, through the end of 2009 no employer had yet incurred a "free rider surcharge," which applies to noncompliant employers if their uninsured employees receive more than U.S.$50,000 of uncompensated care in a year. A survey sample of 1,003 employers in 2008 confirmed >90 percent compliance by larger employers, but found only 72 percent compliance by firms under 51 (Gabel et al. 2008b).[6]

In interviews, employer representatives and advisors in all study states consistently reported employer opposition to government mandating any employee benefits, including section 125 plans. Employers reportedly view mandates as intrusive, inflexible, expensive, and contrary to free market principles. However, these attitudes did not undermine Massachusetts' successful implementation of its section 125 mandate. Initially, this more technical provision of its comprehensive reform law was "the one thing that seemed to cause the most angst" among employers, according to one observer. Others said that insurers, agents, government officials, and trade associations worked hard to assist with the "mad scramble" of meeting compliance deadlines. And, some said that compliance was not that difficult, nothing more than some initial "hiccups." They noted, or we observed, that the Connector, the state's leading insurers, and many agents set up section 125 plans for free, especially for new or established clients. Helpful instruction manuals were available online,[7] some of which enabled those who were so inclined to set up these fairly simple plans themselves; for others, there were assisted options that cost as little as U.S.$100 for initial setup.[8]

In any event, once Massachusetts employers had their section 125 plans in place, then most observers reported that employers generally were quite content with the arrangement. These impressions were confirmed in 2008 by a representative survey of 1,003 employers, showing general support for the overall reform law (Gabel et al. 2008b).

We also inquired why the general idea of offering these plans for uninsured workers to purchase their own coverage has not caught on more in other states. First, cafeteria plans and voluntary benefits are fairly foreign to

smaller employers. For instance, FSAs (which cover out-of-pocket medical and dependent care expenses) are much more prevalent among larger employers. This is also the case for cafeteria plans that cover group health insurance premiums. Almost universally, larger employers deduct workers' portion of group insurance premiums through a section 125 plan, but this is done by only 30–70 percent of firms under 200 (depending on particular survey, year, and firm size grouping), according to national surveys.[9]

Various reasons were cited for smaller employers' tendency to avoid cafeteria plans. First, economies of scale mean that the savings in payroll taxes (coupled with the tax credit in Indiana) may not offset even the modest setup and ongoing administrative expenses. Second, cafeteria plans and voluntary benefits (such as life or disability or cancer insurance) tend to come further down the list of fringe benefits that firms offer (Abraham, DeLeire, and Royalty 2009). By this logic, it would be rare to expect an uninsured firm to jump down the list to the specialized benefits that are less prevalent and so less expected by workers.

Finally, for cafeteria plans a special tax rule requires that no more than 25 percent of the contributions come from owners or highly compensated employees. Many informants noted that this "nondiscrimination" rule is virtually impossible to meet for firms under 10, and it is often difficult for those with fewer than 25 workers, unless business owners and key management decline to use the plan. According to one agent, "They look at you like you're from Borneo if you tell them they can't participate in their own plan."[10]

Other concerns apply to larger employers as well. There are numerous potential complexities that go beyond simply signing the simple startup paperwork. Some arrangements may require employers to deal with list-billing from multiple different insurers. For part-time workers, weekly paychecks may vary, such that wages sometimes fall short of billed amounts, leaving employers potentially on the hook to collect the difference.[11] Also, cafeteria plans work most smoothly when the same amount is deducted from each paycheck for the year, because initial setups cannot be changed absent specified changes in circumstances, and even these require extra paperwork to implement. It all amounts to an administrative "nightmare," according to three different Massachusetts agents.[12]

Legal Uncertainty

A major concern expressed was legal uncertainty under federal law. State law controls whether list-billing violates small-group market reforms, but federal

law controls whether list-billed insurance qualifies for federal tax exclusion (Hall and Monahan 2010). Because of a peculiar quirk in federal law (owing to how HIPAA, ERISA, and the tax code all interrelate), there is a strong, but unsettled, argument that section 125 plans may not be used for health insurance that is medically underwritten (Hall and Monahan 2010). Massachusetts avoided this problem by reforming its individual market, applying the same guarantee issue and community-rating rules to it as it does to small group insurance. In most states, where this is not the case, this federal law uncertainty intimidates many agents, consultants, employers, and benefits administrators from using cafeteria plans for underwritten health insurance. In fact, due to this legal threat, the Missouri Department of Insurance has declined to issue regulations that implement the legislature's section 125 law, since "it would be problematic for employers to place themselves in a position which may conflict with current interpretation of federal law in an effort to comply with Missouri state law."

Potentially, PPACA resolves this problem starting in 2014 by banning medical underwriting. PPACA declares that section 125 plans may not be used for individual insurance purchased through the new exchanges, but it leaves open this possibility for insurance outside the exchanges. However, regulatory guidance is needed to be certain.

Even if this major uncertainty were resolved, other legal concerns would remain. Tax law in general, and cafeteria plan rules in particular, are complex, subject to differing interpretations, and frequently updated with new rulings. Not being in full technical compliance could "blow the whole thing up" (according to a national consultant), causing a significant tax penalty. Even though experts said there is no substantial threat of draconian prosecution for technical violations, benefits advisors and administrators play up this volatile legal environment in sales pitches that tout their professional services.

Nevertheless, most insurers, agents, regulators, and benefits administrators supported these laws, noting that, even where there was not widespread adoption, at least the laws helped to call attention to this low-cost device for reducing employees' premium contributions, either for individual or group insurance.

Employer Crowd-Out

The flip side of low employer take-up is too *much* success for section 125 plans. If they worked too well, they might make individual insurance so attractive that employers stopped offering group coverage. These case studies found some basis to take this "crowd-out" concern seriously. First, the few insurers

who have attempted to develop section 125 plans as a sales vehicle are the same insurers who tend to also specialize in individual insurance. The impetus and support for these laws in each state came in part from some agents or employers whose "eyes light up" (in the words of one state regulator) at the prospect of moving away from employer sponsorship and toward individual purchase. "This is a mission of mine," according to one bill sponsor. The attitude favoring individual over employer group insurance was not widely shared, but those who held it saw establishing section 125 plans as a way for employers to transition out of direct purchase of benefits without abandoning employees' needs altogether. Employers who made this move typically also gave employees a pay raise to compensate for the loss of employee benefits.

A number of informants (including government officials) felt that a section 125 incentive or requirement might push employers over the edge who are already "sitting on the fence," "looking for an excuse to get out of the health insurance business" in a way that is more "palatable." Therefore, insurance regulators in one state (not part of this study) opposed a section 125 mandate, and some knowledgeable experts advise states against adopting section 125 laws unless as part of more comprehensive health insurance reforms, like those in Massachusetts, that also require employer contributions and prohibit medical underwriting (Curtis & Neuschler 2006; Curtis 2008). This concern is also supported, to some extent, by econometric projections that making all health insurance tax excludable would diminish employer-based coverage by roughly 10–15 percent (Royalty 2000; Gruber and Lettau 2004).[13]

Many other informed sources, from all vantage points, thought this level of concern was overblown. They acknowledged the theoretical concern, or that it might happen at the margins, but they noted that employer dropout has been discussed for years but has not happened yet (Fronstin 2007), and they felt that, on balance, it is not likely to become widespread simply because of enhanced tax benefits to employees. Instead, these experts reported that employers decide for independent economic reasons whether they need to, or can afford to, continue offering insurance. If they are forced to drop insurance, then they might consider replacing it with a section 125 plan, but this probably would be only after the fact, as a way to "cushion the blow," recognizing that "something is better than nothing," rather than the section 125 plan being a motivating or causative factor.

Several points were noted frequently in support of this informed view. First, employers and agents who drop group insurance face a legal risk in replacing it with an employer-facilitated arrangement for individual insurance. The insurers who sell individual insurance through list-billing vehicles,

for instance, do so with a clear and firm warning that these are not to be used to replace employer-sponsored insurance. Insurers who promote 125 plans noted that they also have significant business in the small group market, which motivates them to protect that market segment. Others noted that, because section 125 plans can also be used for the employee's portion of group insurance, these plans can help keep the group policy intact. This is because insurers in most states can drop the group if there is not a minimum level of participation among employees, and conferring a tax advantage for family coverage, for instance, can increase employee take-up.

The strongest, and most frequently mentioned, reason given for employers not dropping group coverage is that doing so forces employees to seek coverage in the "wild and wooly" medically underwritten market. Then, employers would have to deal with "grumpy," "resentful" employees who did not pass underwriting. Because PPACA will eliminate medical underwriting in 2014, this raises the concern that employer drop-out might increase. However, in Massachusetts, which also prohibits medical underwriting, employer dropout has not occurred, even though the state also mandates section 125 plans by all employers over 10. Despite this open opportunity, several studies confirm what our informants consistently said—that employer-sponsored insurance has remained intact in Massachusetts (Gabel, Whitmore, and Pickreign 2008a; Gabel et al. 2008b; Long and Masi 2008).

In part, this is because Massachusetts requires employers to contribute to insurance premiums, but this is not a strong mandate, only a mild "pay or play" tax on uninsured firms of about U.S.$300 per employee. Therefore, the primary explanation given was that the individual mandate reinforces labor market pressures to continue offering health insurance as a job benefit. As one Massachusetts agent explained things, before the individual mandate, lower-wage workers would prefer a job that pays U.S.$11/hour with no benefits to one at U.S.$10/hour with health insurance, but now that being uninsured results in a substantial penalty (currently, about U.S.$1,000), this preference has reversed, so even places like fast-food restaurants are starting to contribute to health insurance costs.

Summary and Conclusion

This study provides only a preliminary and limited look at how state laws regarding section 125 plans might work. The observations reported here are based on the following: sharply different versions of the law in each state, implemented in substantially different market contexts; only 2 years' or less

experience under these laws; and market conditions and rules that will change under federal health insurance reform. Nevertheless, the tax laws that make section 125 plans attractive remain in place, and Massachusetts' law in particular is a good preview of how these plans might function within a newly reformed market. Moreover, the other two states give insights into whether adoption might increase through means other than a legal mandate.

Overall, despite various qualms and shortcomings, few informed sources thought that it was a bad idea to encourage use of section 125 plans for individual insurance. Many employers reflexively oppose *mandates* to do so, but resistance to Massachusetts' mandate has abated. Some experts worry that making individual insurance too convenient through the workplace would cause employers to drop their sponsorship of health insurance, but that too did not occur in Massachusetts, and this will be much less of a concern in a marketplace that prohibits medical underwriting of individual insurance.

Still, an overriding question is whether the benefits of section 125 plans are worth the efforts of legislation and implementation. Remarkably few people take advantage of this tax protection in Massachusetts, and many employers resist adopting these plans when given the choice. Therefore, a much more straightforward solution lies at the doorstep of Congress: to reform the inequitable tax treatment of employees' contributions to health insurance, by excluding all insurance premiums from income and payroll taxes, regardless of their source of payment. That simplification of tax laws would avoid the complications of section 125 plans and repair the injustice of uninsured workers being the only people who remain ineligible for tax-sheltered health insurance. Absent federal reform, section 125 plans remain an innovative tool for states and employers to substantially reduce the cost of employees' premium contributions.

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NOTES

1. Missouri also requires employers who purchase group insurance to cover any employee contributions with a section 125 plan, but this portion of the law does not apply to individual insurance and so is not a main focus of this study.
2. Connecticut and Tennessee adopted section 125 requirements in 2007 that apply only to employers who offer insurance (in order to cover the employees' portion of group premiums). Rhode Island and Minnesota each mandated, effective July 1, 2009, that all but the smallest employers (those larger than 25 and 10, respectively) adopt section 125 plans for health insurance, although Minnesota allows employers to opt out without penalty or explanation. Minnesota also provides a U.S.$350 tax credit to defray the administrative costs. Maryland, Florida, and Washington require employers who receive certain state subsidies for insurance to establish section 125 plans that reduce the effective costs to employees. And Kansas declares that section 125 plans are permissible for individual insurance and requires insurers to offer them.
3. Tax effects are not always beneficial, however. Persons nearing retirement might want to maximize reportable income in order to maximize pension and social security benefits (Burns & Associates Inc 2007). Also, at the lowest incomes the phase-in portion of the earned income tax credit rewards people between 0 and 125 percent of poverty more the more they earn, meaning that less reportable earnings can reduce this tax credit more than the taxes they save, making them marginally worse off (Quincy 2008b).
4. In one typical situation, a single worker earning U.S.$50,000 with insurance that costs U.S.$5,000 would save U.S.$1,883 (37.65 percent) in a state with 5 percent income tax. Here are two places to test out other tax scenarios: http://www.coredocuments.com/125savings.php and http://www.dinkytown.net/java/Payroll125.html.
5. Ed Neuschler (2008b), for instance, presents an example of the tax break allowing a lower-wage worker being able to pay 30 percent more of the premium without exceeding an affordability threshold of 5 percent of income, thereby reducing the state's premium subsidy by 22 percent. For additional modeling of the impact on affordability thresholds, see Neuschler (2008a).
6. However, the authors noted that these smaller employers may have misunderstood the survey, thinking it asked only about flexible spending accounts for individual medical expenses, and not about section 125 plans that cover insurance premiums.
7. See, for example, from the Commonwealth Connector: http://www.mahealthconnector.org/portal/site/connector/menuitem.5de15e4af5dc94de505da95c0ce08041. From CoreDocuments: http://www.coredocuments.com/docs/125_Employer_Guide.pdf. From Ceridian: http://www.steveshorr.com/PDF_s/POP%20Admin%20Guide%20(Ceridian).pdf.
8. This does not include charges for ongoing account administration, however. We observed various pricing structures around the country, with some charging several hundred dollars for initial setup, a similar amount for annual maintenance, and typically U.S.$50 a year per employee user.
9. Data come from the Medical Expenditure Panel Survey and from the Employer Health Benefits Survey. Note, though, that smaller employers, who lack in-house

benefits expertise, may not actually know whether employee premiums paid through payroll deduction go through a section 125 vehicle. Because these "premium-only" 125 plans are simple to set up and administer and require no individualized elections by employees, informed sources said they are often done as a matter of course by the payroll or benefits administrative firms to which smaller employers outsource these functions. Also, payroll firms may automatically be treating employee contributions as pretax payroll deductions, without bothering to confirm that the standard section 125 documents have in fact been executed. Therefore, there may be much less failure to offer this easy tax benefit to employees covered by group plans than what appears from these surveys.

10. PPACA contains a new provision that fixes this problem, but only for employer-sponsored insurance, and not when these plans are used to purchase voluntary benefits.
11. Some experts described a creative method to avoid this problem called a "premium reimbursement arrangement," in which employees pay insurance premiums directly and then seek reimbursement through their cafeteria plan (as is commonly done for FSAs) (Glass 2008).
12. For more discussion and documentation, see Burns & Associates Inc. (2007); Carey and Morse (2008).
13. At the same time, Buchmueller et al. (2008) concluded that lowering the cost of individual insurance would increase its take-up, offsetting the employer loss. Also, the CBO (2007) estimated that a more generous tax credit evenly applied to group and individual insurance would increase coverage by 6 million people on balance. However, Blumenthal (2008) has criticized the CBO for substantially underestimating employer dropout.

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SUPPORTING INFORMATION

Additional supporting information may be found in the online version of this article:

Appendix SA1: Author Matrix.

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